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China CITIC Bank London Branch

Risk Appetite Statement



Document History

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1.0	President	President	May 2018	PRA Regulatory Business Plan
1.1	CRO	MANCO	Oct 2018	<ul style="list-style-type: none"> • Background - include HO DOA in Appendix A (1) • Add risk framework/policies (3) • Risk Management Framework (RMF) - add Committee structure (5) • RMF - Remove 3 lines of defense (5) • Business Activities - 'Day 1' products and future products (6.1) • Business Activities - Add details on Target Customers (6.2) • Business Activities - Add customer/product matrix (6.2) • Credit Risk - define credit risk including limits, large exposure, maturity profile, collateral, concentration risk matrix (7) • Market Risk - include FX stop loss (8.2) • Market Risk - define Interest Rate gapping and limits (8.3) • Operational – change to BASEL categories, outline management tools and quantitative risk appetite (9) • Liquidity risk – define risk appetite with LCR and NSFR (10) • Risk Appetite – idiosyncratic stress testing will be developed over time (13.2) • Risk Appetite - RAS usage added (13.5) • Risk Appetite – RAS approval & updates added (13.6) • Remove roles and responsibilities which are detailed in RMF (17)

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1 Background

This document sets out the Risk Appetite Statement (“RAS”) for China CITIC Bank London Branch (“CNCBLB” or “the Branch”). CNCBLB is the UK branch of China CITIC Bank (“The Bank” or “Head Office” or “HO”) and operates in London as a wholesale bank authorised by the Prudential Regulation Authority (“PRA”) and the Financial Conduct Authority (“FCA”), together known as ‘the UK Regulators’. In this document the Branch will identify, define and manage the key risks faced by the business it carries out. The RAS is a key component of the Branch’s overall Risk Management Framework (“RMF”) and allows the Bank to formally define its appetite for the risks it is exposed to.

The RAS considers the UK regulatory requirements, the delegated authority provided by the Bank (see **Appendix A** – HO Delegated Authority) and, where appropriate, the RAS of Head Office.

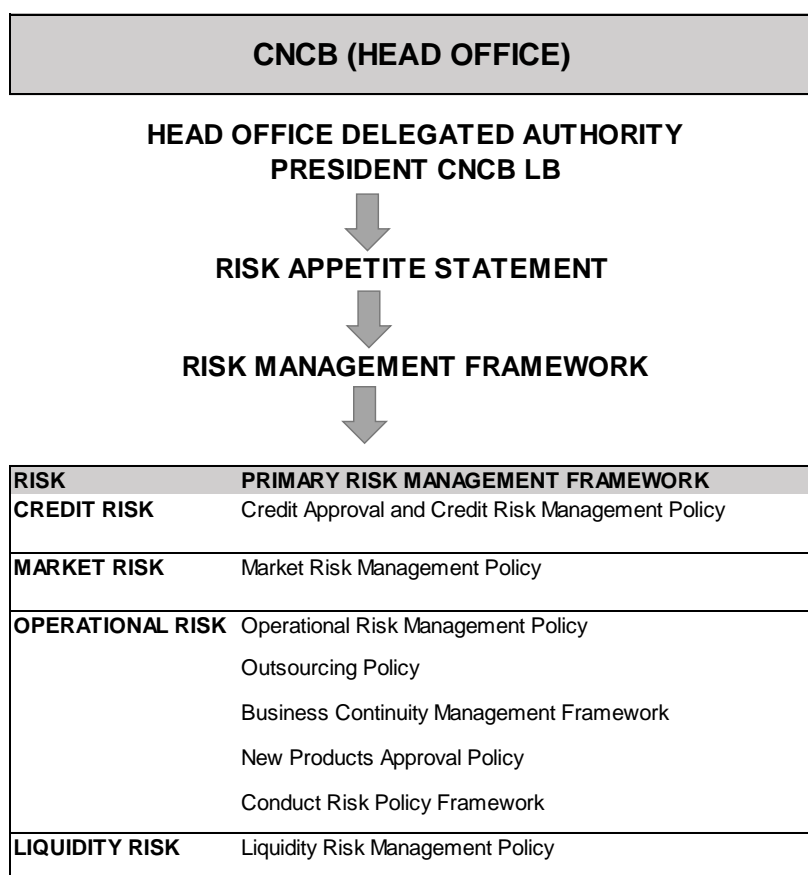
These risks include strategic and financial risks, largely as a result of the economic and political environments that the Branch operates in, and the credit exposure in respect of its lending and investment activities within the business and the treasury operations. The Branch accepts that these activities generate risk and will put in place appropriate systems and controls to manage the risks within the Risk Appetite and strategy established in the Business Plan. CNCBLB also recognises various operational, conduct and reputational risks which are managed by way of appropriate systems and controls proportionate to the size and complexity of the Branch which is supported by a strong risk and compliance culture implemented through a range of policies. Although the Branch accepts that it is neither possible nor desirable to negate all the risks associated with its business, the Bank is very cognisant of the importance of stating clearly, understanding and of managing these key risks appropriately within the approved Risk Appetite Statement.

2 Scope

This RAS sets out the approved business activities to be carried out by the Branch and the amounts and types of risk that the HO, through its delegation of authority (“DOA”) to the President of the Branch has authorised the Branch to undertake. It also documents the associated governance, oversight, monitoring and reporting framework.

3 Objectives

The RAS sets out the parameters that determine which business activities will be carried out by the Branch, and defines the types and levels of risks that the Branch is willing to accept in order to achieve its business objectives. The RAS forms an integral part of the Branch’s Risk Management Framework and should be read in conjunction with CNCBLB’s risk policies and overall risk framework:



The Branch defines ***Risk Appetite***, as the aggregate level of risk it is willing to assume within its 'Risk Capacity' in order to achieve its strategic objectives as expressed in its business plan.

Risk Capacity for the Branch is defined as the maximum level of risk the CNCBLB can assume before breaching constraints determined by:

- i) the delegated authority granted by HO for the Branch to enter into transactions on its behalf; and
- ii) the regulatory regime it is subject to within the UK including, from a conduct risk perspective, its obligations to depositors, other customers and stakeholders.

The Branch's risk capacity is governed by a number of criteria:

- The DOA provided by HO to the President;
- The PRA and FCA Handbooks;
- Availability of working capital; and
- Access to liquidity (including through HO borrowing).

Risk limits have been set within this document that quantify as far as possible the risk appetite of specific risks the branch is willing to take, and this provides a framework within which the business must operate.

4 Document Ownership

The 'ownership chain' of this policy is detailed below.

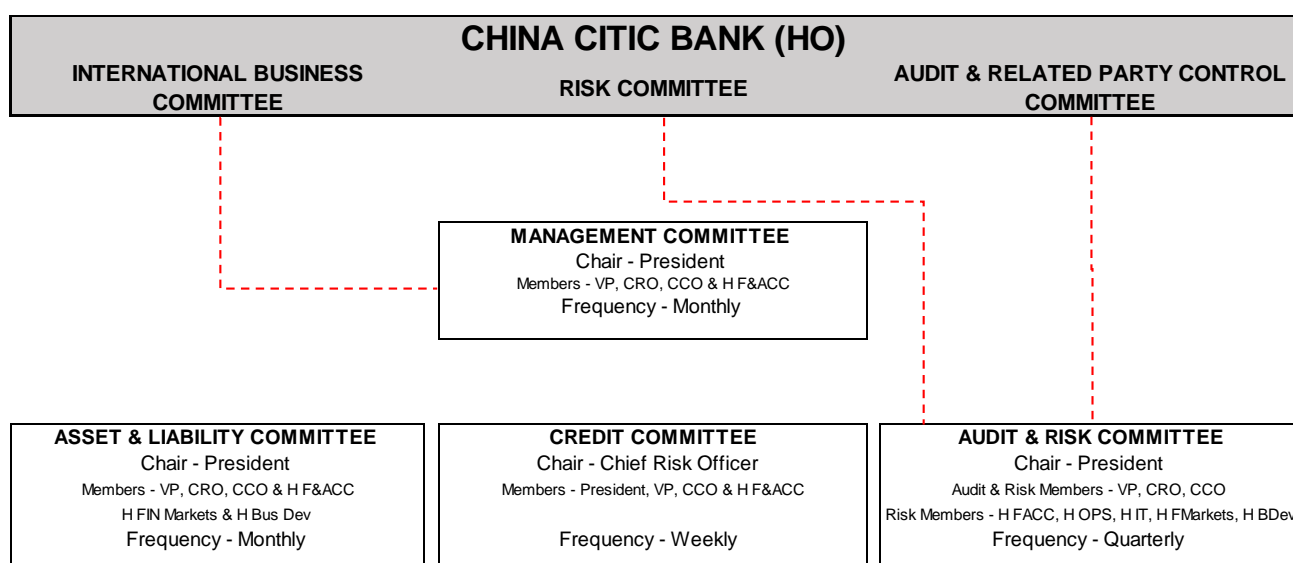
Document Owner	<p>The Branch's Chief Risk Officer ("CRO") is responsible for the maintenance for this RAS.</p> <p>The CRO will also be responsible for reviewing the ongoing adequacy of the RAS and will review it at least on an annual basis or more frequently as required. Any proposed changes to this document must be formally approved by the ManCo. Changes may also require notification to the UK Regulators.</p> <p>The CRO will recommend this action as appropriate for the ARCo to consider.</p>
Oversight and challenge	<p>The ARCo will review and challenge this document at least annually or more frequently as necessary. It will provide challenge to any changes suggested by the CRO before any proposed changes are put to the ManCo for decision.</p> <p>Following their review, the ARCo will recommend (or otherwise) that the ManCo approves the RAS.</p>
Approval	<p>ManCo is ultimately responsible for the approval of this RAS and for ensuring it is set within the parameters of the President's DOA.</p>
Applicability	<p>All members of staff, whether permanent (local hires and/or expatriate) or contractors must operate in accordance with this document as disseminated through policies, procedures and risk limits as applicable to individual roles.</p> <p>Escalation of any matters arising in respect of this should be via the individual's Head of Department or directly to the CRO.</p>

5 Risk Management Framework

The Risk Management Framework (“RMF”) seeks to ensure that there is an effective process in place to manage risk across the Branch.

Risk management is integral to all aspects of the Branches activities and is the responsibility of all staff. Senior Managers and Heads of Departments have a particular responsibility to evaluate their risk environment, to put in place appropriate controls and to monitor the effectiveness of those controls. The risk management culture puts emphasis on careful analysis and management of risk in all business processes.

These risks are identified, assessed and managed at both an enterprise level (‘top-down’) and business level (‘bottom-up’). Through both internal management and functional reporting lines, the Branch reports appropriate risk metrics to HO on a monthly and quarterly basis. The Branch’s Management Committee (“Manco”), which is chaired by the President, has oversight of these processes. This Committee meets monthly and provides a report on its activities to the Branch Audit & Risk Committee (“ARCo”), which meets quarterly and is responsible for reviewing and challenging all reports prior to submission to the relevant HO committees.



In order to have effective oversight of the above, the Branch will operate a comprehensive and robust risk management framework which will identify and manage all risks to which the business is exposed. The risk management framework operated by the Branch will be similar to that implemented by HO and sets out the roles and responsibilities of senior management and the committees.

The RMF is based on the 'Three Line of Defence model'. This allows responsibility and accountability to reside with the relevant persons and/or department, with ultimate responsibility for the Branch's risk framework residing with HO.

6 Business Risk Appetite

This section sets out what business activities (products, services and customer segments) the branch is authorised to carry out both by HO and the UK regulatory authorities.

This means that any activities not included within this section will not be carried out by the Branch.

6.1 Business Activities

CNCBLB will not conduct any retail business, but will undertake wholesale and commercial banking activities. The wholesale and commercial banking activities will be limited to the following:

Business Activity	Products
Treasury	<ul style="list-style-type: none">• Money Market instruments *• FX spot*• FX Forwards / Swaps (non-customer/ hedging only)• Interest Rate Swaps (non-customer/ hedging only)• Liquid Bonds (UK Gilts/ US Treasuries or equivalent) *• Corporate Bonds• Repurchase Agreements 'REPO'

Banking	<ul style="list-style-type: none"> • Transaction accounts (demand/call accounts) * • Term Deposit accounts* • Payment Services (Domestic and International) * • Bilateral loans (Secured and unsecured) * • Syndicated Loans (Secured and unsecured) * • Project Finance • Asset backed structured finance * • Bill and Telegraph Transfer financing • Letters of Credit (issuance, negotiation or risk participation) • Letters of Guarantees • Forfeiting/Receivable financing
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* **Day 1 Products**, products that will have been through the 'New Product' approval process. This requires the sign-off of the business sponsor/owner, operations, finance, compliance and risk departments. The President retains the final veto on all approved products.

All other products are still under development and will not be transacted until they have been agreed under the New Product Approval Policy and process. This process is managed and coordinated by Operational Risk management, within Risk Department.

6.2 Target Customers

The Branch will only transact with wholesale customers. The Branch's customer base can be split into three broad categories and these are listed below:

- **CITIC Group entities**

China CITIC Bank is a core part of the CITIC Group and has a natural advantage in acquiring business from within the Group or from customers of other Group Companies.

Products and Services	Example Group Customer	Access to customers
Project Finance, Syndicated Loans, Bilateral Loans; daily payments and receipts of funds; FX risk management service	CITIC Construction, CITIC Heavy Industries, CITIC Dicastal, CITIC Pacific, CITIC Financial Leasing, CITIC Capital, and CITIC Securities	Through CITIC Group internal publicity and coordination; and marketing visits

- **Domestic HO Customers**

The Branch will target two types of existing Domestic HO customers:

Financial Institutions including domestic CNCB branches

CNCB currently has a network of more than 1,900 correspondent banks worldwide. CNCBLB will benefit from the same credit rating as CNCB (currently Moody Long-Term Rating Baa1 / Fitch Long-term Issuer Default Rating BBB) in the overseas market to raise funds from interbank market.

Products and Services	Potential Customer	Access to Customers
Money Market and fixed income operation including interbank lending, issuing or purchasing CDs, Bond trading, credit asset transfer.	UK FI customers: International banks and Chinese London based banks	Through the head office referral; customers' visits; road show

CNCBLB will also provide trade finance services such as refinance, L/Cs and L/Gs.	China FI customers: China CITIC Bank branches, Zheshang Bank, Guangdong Development Bank and other banks set up in Tier 2 or 3 cities in China.	
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Large Multinational Companies

Large-scale multinational enterprises operating in the EMEA region, including Chinese-funded enterprises always have strong financing capability, while their credit risk is relatively low and business income is relatively stable.

Products and Services	Potential Customer	Access to Customers
Revolving Credit Facility, FX risk management service.	BMW, Mercedes-Benz, Sino Pec, China Oil, China Minmetals, have established long term solid relationships with CNCB HO.	China CITIC Bank London Branch will use China CITIC Bank's head office to get access to the potential customers

- Local HO Customers**

A large number of Chinese companies are based in the UK while many British companies operate and invest in China.

Products and Services	Potential Customer	Access to Customers
Corporate Loans (M&A finance, real estate finance, project finance), Trade Finance and international payments	China Resources, Wanda, R & F Properties, Greenland Group, China Aviation Technologies (UK) and Huawei. The wider Group of HO local customers include but not limited to:	Companies that have already expressed business demand for the London office

	Jaguar Land Rover Automotive PLC (UK); ABP (London) Investment Co., Ltd.; BP; British Airways; Glaxo SmithKline; Aston Martin Lagonda Limited; and AstraZeneca plc.	
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Customer / Product Matrix

The initial phase of CNCBLB customer services will have the following customer and product matrix:

Products		Customers			
Category	Product and services	<i>CITIC Group entities</i>	<i>Domestic HO Financial Institutions</i>	<i>Domestic HO Large Multinationals</i>	<i>Local HO customers</i>
Treasury	Foreign Exchange (Spot Only)	√	√	√	√
	Foreign Exchange Forwards/Swaps		√		
	Interest rate / Cross-Currency Swaps		√		
	Interbank lending / borrowing		√		
	CD's		√		
	Repo's		√		
	Corporate Bonds		√	√	√
	High Quality Liquid Assets ("HQLA")		√		
Corporate Loans	Bilateral Loans	√		√	√
	Syndicated Loans	√		√	√
Trade Finance	Financial Institutions (Refinance, Letters of Credit and guarantees)		√		
	Corporates (Bill advancing, Letters of Credit,	√		√	√

	guarantees, forfaiting and receivable finance)				
Deposit Products	Corporate Current accounts	√		√	√
	Corporate Deposit Accounts	√		√	√
Payment Services	UK Domestic payments	√		√	√
	International payments	√		√	√

CNCBLB will not transact with Small Medium Enterprises (“SME”) and the Branch is aware that within the definition of Retail Customers the following criteria is used to classify SME business:

- Turnover is not more than £10.2 million per annum;
- Balance sheet total of not more than £5.1 million; and/or
- Number of employees is not more than 50.

There will be no customers classified as Retail (as per COBS 3.4).

Similarly, no business is planned in the initial phase of the Branch business activity which would be caught within the scope of MiFID / MiFID II (e.g. no FX products other than spot will be offered) and any Money Market instruments offered will be limited to be either Professional Customers (as per COBS 3.5) or Eligible Counterparties (as per COBS 3.6) taking into consideration qualifying Holding Companies as outlined in COB 3.5.2(3) in relation to non-MIFID business. All new products that may require additional regulatory reporting requirements, will be subject to the ‘New Product Approval process’. This process will require a detailed action plan to be implemented covering the launch of new products, including appropriate systems & controls to ensure compliance with all regulations.

7 Credit Risk

7.1 Credit Risk Exposure

Credit risk is the risk of loss due to one or more counterparties/borrowers/issuers defaulting on, or otherwise being unable to fulfil, their contractual obligations. Credit exposure will be generated by the following products:

Business Activity	Products	Country Risk	Obligor Risk	CP Risk	Issuer Risk	Pre-Settlement	Settlement Risk
Treasury	• Money Market instruments	√		√			√
	• Repurchase Agreements	√		√		√	√
	• FX spot	√		√			√
	• FX Forwards / Swaps	√		√		√	√
	• Interest Rate Swaps	√		√		√	√
	• HQLA	√			√		
	• Corporate Bonds	√			√		
Banking	• Payment Services	√	√				√
	• Bilateral loans	√	√				
	• Syndicated Loans	√	√				
	• Project Finance	√	√				
	• Asset backed structured finance	√	√				
	• Bill and Telegraph Transfer financing	√	√				
	• Letters of Credit	√	√				
	• Letters of Guarantees	√	√				
	• Forfeiting/Receivable financing	√	√				

Definitions

CNCB LB defines credit risk management in 5 categories:

1. **Country Risk** - risk that a foreign government will default on its financial commitments or restrict business/trade flows or the degree to which political and/or economic unrest impacts doing business in a particular country;
2. **Obligor Risk** - also known as a debtor, potential default by entity who is legally or contractually obliged to make all principal repayments and interest payments on outstanding debt;
3. **Counterparty Risk** - the risk to each party of a contract that the counterparty will not meet its contractual obligations;
4. **Issuer Risk** – the legal entity that issues a financial instrument, any investor in the financial instrument incurs not only the market risk associated with any type of investment, but also an issuer-related default risk.
5. **Pre-settlement risk** – the risk that a counterparty defaults prior to maturity of a transaction which results in a market-to-market (plus credit add-on) exposure or replacement cost; and
6. **Settlement Risk** – unless settled ‘Delivery verse Payment’ (“DVP”) through an approved clearing house/exchange; settlement risk is the risk that a counterparty or intermediary agent fails to deliver cash or a security as per the agreement.

7.2 Credit Risk Mitigation

The following mitigants are employed by the Branch to help manage its exposure to credit risk:

- Avoiding concentrations of risk by limiting exposures to individual counterparties/borrowers and groups, and diversifying exposure across different counterparties, thereby reducing the impact of a single counterparty default;
- Ensuring robust initial and ongoing credit analysis of counterparties, groups and countries;

- Settlement of transactions through approved payment systems or on a delivery-versus-payment basis;
- Limiting exposures to individual countries and industry sectors, and diversifying exposure across different countries and sectors to the extent that it is possible within the constraints of the overall business model of the Branch;
- Setting limits on tenures of transactions with counterparties;
- Utilising netting and collateral agreements where possible;
- Ensuring robust documentation of transactions, including setting appropriate covenants, where possible; and
- Where possible, obtaining HO or third-party guarantees to reduce the risk of loss.

7.3 Credit Risk Appetite

The Branch has set its Risk Appetite in respect of credit risk as follows:

- No obligor/counterparty/issuer should exceed USD 50 million or 25% of the total credit exposure based on the Total Risk Weighted Assets ("TRWA") calculation ($TRWA = EAD \times PD \times LGD$ and/or $EAD \times \text{Standard Approach CCR}$);
- Provision coverage ratio of NPL $\geq 150\%$;
- Non-Performing Loan ratio $\leq 2\%$;
- Loan Book Portfolio - Average 12 months Default Probability of Corporate Business $\leq 1\%$; and
- Treasury Portfolio - Average 12 months Default Probability of Financial Institutions Business $\leq 1\%$

Furthermore, under the HO DOA provided to the President (see **Appendix A**), the Branch exposures must conform to the delegated authority agreed in the HO DOA.

The HO DOA will be reviewed at least annually and any changes to the approval will be incorporated into the RAS and communicated to the relevant members of staff. Further to the HO DOA, the branch implements additional credit control methodology to manage this risk, these measures include:

Credit Risk Maturity Profile

Business Activity	Products	Maximum Tenor
Treasury	• Money Market instruments	1 year
	• Repurchase Agreements	1 year
	• FX Forwards / Swaps	5 years
	• Interest Rate Swaps	5 years
	• Liquid Bonds (Gilts/Treasuries or Equivalent)	10 years
	• Corporate Bonds	5 years
Banking	• Bilateral loans	5 years
	• Syndicated Loans	5 years
	• Project Finance	5 years
	• Asset backed structured finance	5 years
	• Bill and Telegraph Transfer financing	2 years
	• Letters of Credit	2 years
	• Letters of Guarantees	2 years
	• Forfeiting/Receivable financing	1 year

Credit Risk mitigation (acceptable collateral)

Collateral Type	% Haircut/Loan to Value	
	Financial Institutions	Corporate
Cash	100%	100%
Bonds	Custodian/Clearing haircuts – credit quality, maturity/currency	Depending on assessed credit quality & liquidity
Equities	N/A	50%
Credit Derivatives/Other direct credit substitution	100%	100%
Bank guarantees/Letters of Credit	Depending on assessed credit quality	Depending on assessed credit quality
Asset Backed		
- Residential Real Estate	N/A	70%
- Commercial Real Estate	N/A	60%
- Industrial Real Estate	N/A	50%
- Other assets	To be determined by Risk	To be determined by Risk

Credit Concentration Risk

Concentrations can arise with regard to material individual exposures to a single counterparty or group of connected counterparties, to exposures to counterparties located within a particular geopolitical region, or exposures to counterparties from a particular industrial sector. Any such concentrations could leave the Branch vulnerable to a stress that could potentially impact CNCBLB meeting its strategic objectives. Therefore, the Branch has set Risk Appetite limits in relation to these concentrations as detailed below:

Credit Risk Concentration Matrix

Risk category	Risk type	Risk measurement	Risk appetite		
			Maximum exposure		
Risk Profile	Total RWA	HO Internal Rating	HO	100%	
			AAA to A	100%	
			BBB	75%	
			BB	50%	
			Below BB	0%	
Currencies	Approved currencies	Net exposure to Total Assets:			
		USD		100%	
		RMB		100%	
		GBP		50%	
		EURO		50%	
Geography	Country risk exposure	Net exposure to Total Assets:			
		China		100%	
		United Kingdom		100%	
		United States of America		100%	
		Europe (excluding UK)		80%	
		Total Other Countries (Maximum 20% per country)		50%	
Sector	Industry and sector exposure	Net exposure to Total Assets:			
		Sovereign/Government		100%	
		Financial Services		100%	
		Real Estate		30%	
		Retail/Wholesale trade		40%	
		Business services		25%	
		Mining & Energy		25%	
		Manufacturing		30%	
		Construction/Infrastructure		35%	
Customer Type	Exposures to customer types	Net exposure to Total Assets:			
		Sovereign/Government		50%	
		Financial Institutions		80%	
		Corporate		70%	
Customer/Product matrix	Product Concentration Limits as a maximum % of Loan Book				
	Bilateral Loans	Syndicated Loans	Trade Finance	Asset Backed	Project Finance
Domestic HO	90%	90%	90%	90%	50%
CITIC Group Entities	60%	60%	60%	60%	60%
Local HO Customers	100%	100%	100%	50%	50%

The management of credit risk, including the above risk appetites and concentration limits, are defined in detail in the '**Credit Approval and Credit Risk Policy**'.

8 Market Risk

8.1 Market Risk Exposure

Market risk is the exposure to adverse changes in the market value of financial instruments caused by market factors such as interest rates, foreign exchange rates and volatility. Foreign exchange risk and interest rate risk are the primary forms of market risk which the Branch is exposed to through lending in currencies other than base currency, lending at fixed rates and treasury operations.

Financial Markets department are responsible for managing market risk. The ManCo and the ALCo both have responsibility for monitoring the market risk which comprises mainly of:

8.2 Foreign Exchange Risk

Foreign exchange risk refers to the risk of on and off-balance sheet businesses of a bank incurring losses due to unfavourable changes of exchange rates. The Branch will measure foreign exchange risk mainly through the analysis of foreign exchange exposures that consist of trading and non-trading exposures, including trading exposure that mainly results from the position in foreign exchange trading and non-trading exposure that mainly arises from foreign currency capital and foreign currency profit.

The calculation of a Foreign Exchange ("FX") Net Present Value/Delta ("NPV") for its FX risk exposure for all currencies. FX NPV is calculated by estimating the present value of each position by using the forward curve implied interest of each currency

Proprietary trading	Description
Currencies	USD, RMB, GBP, EUR

Intra-day limit	\$10 million
Overnight limit	\$2 million
Annual stop loss	\$250,000

Financial Control independently monitors the actual P&L against the USD 250,000 loss limit on a daily basis by calculating Treasury P&L which is circulated to senior management. If a loss limit is actually breached (or in the judgment of the manager such a loss limit is likely to be breached) then a report of the actual (or probable) breach will be required from the Head of Financial markets laying out the strategy and recommendation as to how the risks should be managed. ManCo will review and consider the proposal and either approve or determine actions required.

The Head of Financial Markets will in consultation with the Vice President set loss limits at various sub-desk levels such as book or a trade, if required.

8.3 Interest Rate Risk

Interest rate risk refers to the risk of losses to overall earnings and economic value of bank accounts resulting from unfavourable changes in factors such as interest rate and maturity structure, including re-pricing risk, yield curve risk, benchmark risk and option risk.

A 'gap' approach to measure its Interest Rate Risk in Banking Book, ("IRRBB") exposure. This is determined as the maximum net position of interest earning assets and interest paying liabilities utilising actual maturity or maturity for interest rollover whichever is earlier.

Gapping Limits - Interest rate gapping limits are set in order to control CNCBLB's exposure to the interest rate risk arising from its business activity and restricts the re-pricing risk over various maturity buckets. The degree to which CNCBLB would be exposed to interest rate risk is identified through gap analysis using the principle of grouping together assets and liabilities that are affected by interest rate changes according to their maturity dates. Two different types of gaps may occur:

- A negative gap occurs when interest-sensitive liabilities maturing at a certain time are greater than interest-sensitive assets maturing at the same time. This results in a net exposure if interest rates rise by the time of maturity;
- A positive gap occurs if the amount of interest-sensitive assets maturing in a certain period exceeds the amount of interest-sensitive liabilities maturing at the same time. In this situation the firm will be negatively impacted if interest rates fall by maturity.

Traditionally banks borrow funds with short dated maturities and lend them over a longer term to take advantage of a positive yield curve. CNCB's funding is split between HO (evergreen and commercial funding) and customer call/fixed-term deposits; and depending on market conditions Treasury will hedge the interest rate risk by using interest rate swaps thereby locking in the margin and removing any interest rate risk. If not hedged perfectly, this creates a liquidity mismatch in the respective maturity buckets. In the expected gapping profile, the majority of interest rate risk is hedged, therefore, if interest rates rise or fall there will be minimal impact.

The risk appetite for interest rate gapping is articulated in the following table:

Tenors	Net Interest rate exposure / Total Balance sheet (maximum percentage)
Up to 8 days	100%

8 days to 1 month	60%
Up to 3 months	50%
Up to 6 months	40%
Up to 9 months	30%
Up to 12 months	25%
Up to 24 months	10%
Up to 60 months	0%

The Branch will manage its interest rate risk for the overall objective of observing the principle of prudent risk preference and achieving steady growth of both net interest income and economic value within the acceptable range of interest rate risk. Interest rate sensitivity analysis will be conducted by Risk department on net interest income based on DV01 (USD value of 1 bps), ± 100 bps and ± 200 Basis Points (“bps”) shift in the curve. Limits or early warning triggers will be set before the next review date of the RAS.

The management of market risk, including the above risk appetites and concentration limits, are defined in detail in the '**Market Risk Policy**'.

9 Operational Risk

9.1 Operational Risk measurement

Operational risk is the risk of an economic loss, a disruption to business, an adverse impact on reputation or on client relationships or of legal action arising from inadequate or failed internal processes, people and systems. Operational risk will generally occur due to either inadequate or failed internal processes, staff, IT systems or other external factors. Within this broad classification, the Branch will identify a number of categories of operational risk that are aligned with market standards under the regulatory requirements:

OPERATIONAL RISK	BASEL EVENT TYPE	DESCRIPTION
PEOPLE RISK	Internal Fraud	Losses due to acts of a type intended to defraud, misappropriate property or circumvent regulations, the law or company policy, excluding diversity/ discrimination events, which involves at least one internal party
	External fraud	Losses due to acts of a type intended to defraud, misappropriate property or circumvent the law, by a third party
	Employment Practices and Workplace Safety	Losses arising from acts inconsistent with employment, health or safety laws or agreements, from payment of personal injury claims, or from diversity/ discrimination events
PROCESSES RISK	Clients, Products & Business Practices	Losses arising from an unintentional or negligent failure to meet a professional obligation to specific clients (including fiduciary and suitability requirements), or from the nature or design of a product
	Execution, Delivery & Process Management	Losses from failed transaction processing or process management, from relations with trade counterparties and vendors
	Business disruption and system failures	Losses arising from disruption of business or system failures
SYSTEMS RISK		
EXTERNAL RISK	Damage to Physical Assets	Losses arising from loss or damage to physical assets from natural disaster or other events

The operational risk management of the Bank follows the principle of “comprehensive management, clear responsibility, tiered control, and fulfilled responsibility”. As for the operational risk management, the Bank implements identification, assessment, monitoring, control, mitigation and reporting of operational risk through the establishment and improvement of the operational risk management framework. Besides, the Bank takes effective control measures to reduce the loss of operational risk, promote the construction of operational risk management system and constantly improve the operational risk management mechanism of dynamic management and continuous improvement.

The four operational risk tools that will be used to identify, measure, manage and report operational risk are:

- Incident/Near miss log (includes root cause analysis, corrective and preventative actions)
- Risk & Control Self-Assessments (Departmental risk identifications and controls)
- Key Risk Indicators (monitoring and reporting of key risks to senior management)
- Scenario analysis (conduct and non-conduct risk scenarios that could negatively impact CNCBLB)

9.2 Operational Risk Appetite

The Risk Appetite with respect to operational risk is as follows:

CNCBLB is a start-up operation and therefore has no historical data and may be subjected to higher people, processes and system risks in the initial stage of its strategic development. In order to quantify an acceptable risk appetite for operational risk exposure, a dynamic methodology will be

monitored by risk department to manage the higher risk in the initial stages; this risk will reduce as the people, process and systems are strengthen over time, the following table refers:

	Year 1	Year 2	Year 3	Year 4	Year 5
Operating Income	\$3,100,000	\$5,600,000	\$11,100,000	\$17,300,000	\$23,600,000
Tolerance Risk Appetite (bps)	1.25	0.85	0.50	0.25	0.25
Ops Risk Appetite	\$38,750	\$47,600	\$55,500	\$43,250	\$59,000

The management of Operational risk, including the above risk appetites and concentration limits, are defined in detail in the '**Operational Risk Policy**'.

10 Liquidity Risk

10.1 Liquidity Risk exposure

Liquidity risk is the risk that the Branch does not have sufficient liquidity resources available to enable to it meets its payment obligations as they fall due. Liquidity risk can also take form if the Branch is unable to obtain adequate funding in a timely manner at a reasonable cost.

Liquidity risk management will be managed by HO on a Group-wide basis, the Branch is expected by HO to develop and maintain appropriate liquidity policies and limits to ensure it to operate prudently on a day to day basis. The Branch will operate an Asset and Liability Committee ("ALCo") which will be supported by ManCo in ensuring ongoing adherence to the limits set for liquidity risk.

Liquidity risk is quantified in terms of stress scenarios covering intraday, short-term (30 days) and medium-term (1 year) and are applied to CNCBLB's sources of funding. This methodology considers the possibility that CNCBLB cannot raise funding from its normal sources, and takes into account

both cash inflows and outflows. The stress scenarios will reflect the risk that expected cash inflows may not occur or there may be unexpected draw-downs from committed facilities or under collateral arrangements, and the degree to which CNCBLB's liquid assets can cover any shortfall in the ability of CNCBLB to meet its obligations.

The Branch will monitor its liquidity risk appetite against the following metrics:

- The Liquidity Ratio, defined as the balance of Branch liquid assets / Balance of Branch liquidity liabilities.
- Liquidity Coverage Ratio ("LCR") : the LCR considers short-term liquidity risk using a stress scenario in the 30 day maturity bucket. The outflows are stressed to 40% against inflows to calculate the net cash outflows. The net cash outflows in the 30-day maturity bucket are measured against CNCBLB's liquidity buffer to calculate the LCR.
- Net Stable Funding Ratio ("NSFR"): the NSFR ratio considers medium-term liquidity risk using stress scenarios in the amount of stable funding available against required stable funding, out to 1 year.

10.2 Liquidity Risk Appetite

The Branch has set the following liquidity risk appetite:

- The Liquidity ratio must not fall below 30%;
- The One Month Liquidity Coverage Ratio must not fall below 75%; and
- Net Stable Funding Ratio must not fall below 90%.

The CNCBLB 'Liquidity Buffer' will be restricted to 'High Quality Liquid Assets ("HQLA") that will consist of cash, Central Bank deposits and Level 1 securities, as defined under the Commission Delegated Regulation (EU) 2015/61.

The management of Liquidity risk, including the above risk appetites and concentration limits, is defined in detail in the '**Liquidity Risk Policy**'.

11 Other Risks

11.1 Legal Risk

Legal risk is the risk of loss caused by a transaction failing to perform in the way expected due to failure to correctly document, enforce or adhere to contractual arrangements, or due to the legal process failing to enforce the terms of a contractual arrangement or due to a change in the law.

Note that the risks associated with legal actions arising from the Branch's activities are considered to be operational risks associated with those activities. The Branch identifies two key sources of legal risk in its business:

- **Lack of documentation or legally ineffective documentation:** transacting with counterparties prior to completing documentation or executing on the basis of ineffective documentation; and
- **Reliance on enforcement of netting and collateral agreements or guarantees:** evaluating credit exposures on the assumption that: (a) netting arrangements within the trade documentation; and/or (b) collateral agreements and/or (c) guarantees will be enforceable, or will apply, in the event of a counterparty default.

The Branch has zero appetite for legal risk and must ensure the highest level of legal protection from appropriate legal advisors prior to any transaction being executed and if required, any changes that may occur during the life-span of a transaction.

The risk management process implemented will ensure a high level of due diligence in the identification, monitoring, reporting and management of Legal risk to ensure that the Branch understands that legal risk can crystallise from time to time and actions plans are in place to deal promptly and decisively with any such situation.

11.2 Compliance and Regulatory Risk

The Branch defines compliance and regulatory risk as the failure to meet UK and/or Chinese regulatory requirements and the potential impact of changes in regulatory rules. In terms of compliance risk, the risk is caused by failing to adhere to policies, procedures and framework as mandated by Head Office, the UK regulations or internal policies and procedures. The Branch is aware that as part of its day to day operations it will open itself to many different forms of compliance risk such as transaction reporting, treating customers fairly, best execution, bribery & corruption rules, anti-money laundering (“AML”), financial crime and conduct risk.

From a conduct perspective, The Bank will only offer its customers “plain vanilla” services and products, and will ensure that its staff training and documented processes and procedures, are of sufficient standard to minimise the risk of compliance failures or reputational issues arising from its dealings with customers.

The Branch accords the highest importance to complying with applicable internal processes, policies and banking regulation at all times and has no appetite for any breach of policies, laws, regulatory rules or requirements.

11.3 Strategic Risk

Strategic risk is the risk of an external or internal event preventing the Branch from achieving its objectives. The Branch has identified the following sources of strategic risk to its business:

- **Economic risks:** changes in interest rates, global growth and other macroeconomic risk factors;
- **Competition:** competition from other Chinese Banks based in the UK or Europe, and from other Chinese financial institutions looking to develop their presence in Europe;
- **Significant Losses:** significant losses, particularly from credit events, but also from market movements, or regulatory action could severely impact the Branch's ability to achieve its objectives;
- **Political and Regulatory Risk:** for instance consequences of Brexit or a change in the regulatory approach to non-EEA branches in the UK; and
- **Staffing:** The Branch has a limited number of staff to carry out its business and it is a critical risk to attract and retain the right staff to meet the strategic objectives.

The Branch has the following mitigants in place:

- Discussion of emerging issues in all committees;
- Staff meeting discussions;
- Periodic video conferencing with HO;
- Network meetings with related parties;

- Policy guidelines;
- Regulatory inputs;
- Interactions with external skilled persons/consultants; and
- Internal/external audit reports.

11.4 Conduct Risk

Conduct risk is managed in both Compliance and Risk Departments, as this risk relates to the internal risk culture, customers being treated unfairly or being disadvantaged by the actions of the Branch. The Branch has adopted local policies as a framework for conduct risk that reflects the UK regulatory environment. It also includes the risk of failing to meet market rules or standards, or general laws covering the Branch's activities. Any breach of the conduct rules will be reportable to ManCo and the UK regulatory authorities.

The Branch has no tolerance for any breaches of conduct rules, code of conduct and market standards. CNCBLB acknowledges that conduct risk could occur at a number of points on the customer journey, from the design of the product, to the way the product is sold, to the ongoing servicing of clients' needs. The senior management of the Branch recognises that governance and the underlying culture of the organisation will be central to the management of conduct risk.

The Branch will operate in the wholesale market and not in the retail market space, and its clients will be categorised as MiFID Eligible Counterparty or Professional. The Branch will thus develop its conduct risk framework to appropriately identify, monitor and manage the universe of pertinent potential wholesale conduct risks.

At a high-level conduct risk can be divided into five categories:

- **Failure to consider our client's needs:** Can include the selling of inappropriate products to clients or inadequate ongoing review of products and services for clients;
- **Failure to treat clients fairly or to act in their best interests:** Can include providing misleading marketing information on products, pricing products inappropriately, failing to provide best execution of client orders, failing to deal appropriately with client complaints;
- **Failure to meet required standards:** Intentionally or unintentionally failing to meet market rules or standards, or the general regulatory or legal framework within which business is done, including anti-bribery and corruption legislation or sanctions rules;
- **Failure to implement systems infrastructure adequate to meet clients' needs:** Where for example, operations and systems are set up in such a way that the ability on the Branch to transact business in a reliable and transparent manner is hampered by poor systems infrastructure and/or maintenance; and
- **Failure to implement governance arrangements or management information to enable effective oversight or management of conduct risk:** The Branch may inadvertently increase the incidence of conduct risk by not taking appropriate steps to organise and maintain the oversight of conduct risks within its business.

To support the management of conduct risk, CNCBLB will determine and monitor a set of Key Risk Indicators ("KRIs"). The Chief Risk Officer will be responsible for the establishment, maintenance and the monitoring of these KRIs and on a monthly basis providing Management Information ("MI") to the ManCo. If certain KRI trigger thresholds are breached, this will be reported with a recommendation for mitigating action and a target remediation date to the Chief Compliance Officer, the ARCo and the ManCo.

11.5 Outsourcing Risk

The Branch considers outsourcing risk a sub-set of operational risk management framework and defines this risk as the failure to have effective oversight of existing and proposed outsourcing arrangements. All outsourcing and third-party arrangements will be in-line with FCA SYSC 8 and take reasonable steps to avoid undue additional operational risks, this will include assurance that outsourced function do not impair:

- The quality of internal controls; and
- The ability for the regulators to monitor the Branches compliance with all obligations under the regulatory systems relevant to the Branch.

CNCBLB is aware that in undertaking outsourcing activities, the process gives rise to several risks that need to be appropriately mitigated:

- **Business Strategy Risk** – the risk arising from erroneous business decisions, improper implementation of decisions or lack of responsiveness to industry changes. This risk is a function of the compatibility of organisation's strategic goals, the business strategies developed to achieve those goals, the resources deployed against these goals and the quality of implementation. The service provider may conduct business on its own behalf, which is inconsistent with overall strategic goals of the Branch;
- **Reputational Risk** – the risk arising from negative public opinion. The risk may expose the institution to litigation, financial loss or a decline in customer base. Poor service from the service provider and its customer interaction not being consistent with the overall standards of the Branch;
- **Legal and Compliance Risk** – The failure of a service provider in observing with UK legal and regulatory requirements can lead to levying of fines, penalties or punitive damages, resulting

from supervisory actions. Additionally, risks arise from the degree of certainty the Branch has in respect of enforcing a contract;

- **Operational Risk** – This risk arises due to technology failure, fraud, error, inadequate financial capacity to fulfil obligation and/or provide remedies;
- **Exit Strategy Risk** – This could arise from over-reliance on one firm, the loss of relevant skills in the Branch itself preventing it from bringing the activity back in-house and contracts entered into wherein speedy exits would be prohibitively expensive; and
- **Concentration and Systemic Risk** – Due to lack of control of the Branch over a service provider, more so often when overall banking industry has considerable exposure to one service provider. Failure of a service provider in providing a specified service, a breach in security/confidentiality, or non-compliance with legal and regulatory requirements, among others may lead to reputation / financial losses for the Branch and may also result in systemic risks within the banking system in the country.

The Chief Risk Officer will be responsible for the adequacy of the outsourcing risk framework implemented by the Branch as detailed in the Outsourcing Policy. Within this framework, individual SMFs will be allocated responsibility for the relationship with specific service providers.

On engaging with a service provider, the business owner and risk department undertakes a risk assessment exercise in conjunction with the prospective service provider. This assessment is used to identify the key risks associated with the proposed service(s) to be outsourced. The business owner is also required to develop, in partnership with the service provider, a methodology covering system and controls to manage the risks identified. The details of the risk assessment and the KPIs used for managing this risk is covered in the Branch's Outsourcing Policy.

12 IT Risk

The Branch defines IT risk as the failure of computer and infrastructure related to IT. It is the risk of a threat exploiting vulnerability of an IT based asset or group of assets which will in turn cause harm to the organisation.

The Branch will have detailed IT risk management methods, to improve the security protection of the computer systems, networking and production environments. In addition, a comprehensive and effective IT risk management framework will be implemented and will adhere to the HO's "IT Risk Management Regulations".

13 Risk Appetite Statement - Governance

The governance framework around the Branch's RAS along with roles and responsibilities are covered in the Risk Management Framework. The local responsibility for the review and challenge of the RAS lies with ManCo, within the criteria set in the DOA and oversight of HO's International Business Committee.

13.1 Exceptions

Circumstances may arise whereby the business wishes to pursue an opportunity outside the Branch's agreed Risk Appetite (and by extension the President's delegated authority "DOA"). Unless otherwise provided for in this document, the opportunity must first be reviewed and approved by the ManCo and then escalated to HO for final approval.

Only following approval by the ManCo and the HO can any such opportunity be pursued.

13.2 Stress Testing

A stress testing framework will be developed by the Risk department to provide stress scenario analysis and testing on a periodic basis. This will be developed overtime using income statement and balance sheet data to determine both idiosyncratic and market stress scenarios and will be based on the Risk Appetite parameters defined in this document, regulatory business plan and risk policies.

Results of the scenario analysis and stress testing process will form the foundation of the stress-testing framework which will be presented to the ARCo and ManCo. This framework will provide the basis for the review of the RAS and will inform senior management of the appropriateness of the Risk Appetite quantification and whether or not any amendments should be considered to the size of the Risk Appetite or associated limits.

13.3 Management Information and Reporting

Management Information ("MI") will be produced on a regular basis and these will contain metrics based on the stated appetites contained within the RAS. MI relating to the branch performance against its stated Risk Appetite measures will be included within the regular reporting received by the ManCo (monthly) and the ARCo (quarterly).

In addition, the Risk department will monitor the Risk Appetite limits daily and present compliance at the ManCo and ARCO meetings. In the event of a breach of RAS, the specific circumstances must be reported in accordance with section 12.4 below.

13.4 Escalation of RAS Breaches

The Risk department through the CRO will be responsible for escalation of breaches to the respective committees. The escalation procedure differs depending on the nature of the breach:

- **Risk Appetite Metric:** Breach of the Risk Appetite parameters; and
- **Management Action Limits:** Breach of parameters set by ManCo (in order to provide early-warning triggers as key ratios approach the Risk Appetite threshold).

Figure 1 RAS Escalation Points

Report to	Timing	Responsibilities
Risk Appetite		
ManCo	Immediate	Review challenge and approve corrective actions, and oversee corrective action(s)
ARCo	Immediate	Oversee implementation of corrective action(s)
Management Action Limit		
ManCo	Regular MI pack	For information
ARCo	Immediate	Oversee implementation of corrective action(s)

While escalation of a breach would be immediate (aim for this to occur within the working day on which the breach was identified), the relevant authority in conjunction with the Risk department shall provide to ManCo a more detailed explanation along-with the steps being taken by the Branch within a period of three working days.

13.5 RAS Usage in CNCBLB

The RAS is set out in sufficient detail to enable ManCo and ARCo to review and the risk profile of the Branch and report to HO Risk Committee. Compliance with this RAS is mandatory and will be monitored and reported in accordance with the risk management processes set out in the Risk Management Framework.

13.6 RAS Approval and Update

The RAS has been prepared by the CRO and it will be reviewed, challenged and approved by the ManCo at least annually or more frequently should changes in the business plan or activities occur.

14 Appendix A – HO Delegated Authority